May 15, 2017

Comments on the second consultative document
Guidelines: Identification and management of step-in risk

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the second consultative document, *Guidelines: Identification and management of step-in risk* issued by the Basel Committee on Banking Supervision (the "BCBS"). We respectfully request that the following comments should be considered for your further discussion.

[Executive Summary]

We welcome the BCBS's proposal of a tailored approach that allows to address step-in risk on a case-by-case basis (Pillar 2-based approach), rather than a globally uniform approach (Pillar 1-based approach), in response to our comments provided for the first consultative document.[1] Given that business models, business practices, legal systems, supervisory frameworks and other elements differ across jurisdictions, it is crucial to manage step-in risk under a flexible framework.

Nonetheless, in the event that an entity with which a bank has a business relationship faces financial distress, there is a concern that this regulatory framework may become a blocking factor and disincentivise banks from providing liquidity and other forms of support to such an entity. This may lead to an increase of systemic risk, and the public sector with the function as lender of last resort could be forced to provide liquidity and other forms of support in order to ensure financial stability. We therefore expect that thorough consideration will be made on various potential impacts this regulatory framework could give on securing stability in global financial system.

We understand that this regulatory framework requires banks to self-assess "residual risk" that is not captured through the regulations that have been developed so far (including the enhancement to a large exposure framework, capital requirements for banks' equity investments in funds and securitisation exposures, and Money Market Fund Reform). In the light of this understanding, the proposals in this consultative

[1] "Comment on the Consultative Document: Identification and measurement of step-in risk" issued by the Japanese Bankers Association (March 17, 2016)
https://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion280337.pdf

document include those requirements that are practically difficult to comply with and need further clarification of definitions. We expect that the review of requirements would enhance the framework to be better-balanced from perspectives of costs and benefits.

In the following section, we would like to comment from the practical perspective on matters that may help supervisors and banks to take actions in line with the objectives of this consultative document.

[Specific Comments]

1. Steps for managing step-in risks

"1.4. Structure of the framework" provides the steps to first set "all entities" as the population to be evaluated for potential step-in risk, and then identify entities that are immaterial or subject to collective rebuttals and exclude them from the population.

These steps however should be changed to first identify the classes and types of entities that are immaterial or subject to collective rebuttals and exclude them from entities to be evaluated, and then remaining entities should be set as the population.

If the classes and types of entities that are immaterial or subject to collective rebuttals are clearly identified, then the population will be able to set appropriately. Therefore, this approach will not require banks to carry out the identification and aggregation process for both entities which have so little or no step-in risk that are subject to collective rebuttals and those are immaterial.

2. Definition and scope of step-in risk

(1) Unconsolidated entities

It seems that, according to paragraph 18, the scope of entities to be evaluated for step-in risk is virtually unlimited. Given the backgrounds of discussing this framework, however, the scope of entities to be evaluated should be limited to shadow banking entities.

This regulatory framework is a part of initiatives by the Financial Stability Board (FSB) to strengthen the oversight and regulation on the shadow banking system, and its objective is to "mitigate systemic risks, in particular, arising from banks' interactions with shadow banking entities." In the light of this, the framework which may also include commercial entities in the scope depending on an interpretation would be considered overly conservative. Furthermore, the inclusion of all commercial entities in which banks involve would place significant practical burden on such banks.

(2) Collective rebuttals

We request the BCBS to publish a list that provides laws and regulations which are deemed to have effects of collective rebuttals. A list prepared by the BCBS that shows the status of implementing a countercyclical capital buffer (CCyB) at each jurisdiction could be an example for reference.

The publication of such a list is expected to significantly simplify the self-assessment procedures by banks. If effects of collective rebuttals are identified in one jurisdiction, this is expected to provide a clue to review whether similar regulations in another jurisdiction may be a case of collective rebuttals.

3. Reporting templates

If banks would be required to report entities that are immaterial using the reporting templates, data such as the total asset size, which can be available only when banks obtain directly from such entities, should be eliminated. Immaterial entities are those with slight relationship with banks, hence information available from such entities is also limited for those banks. We believe that obtaining additional information from such entities, even immaterial, will impose more considerable burden on banks comparing benefits to be gained.

Moreover, we propose that the reporting templates should be required only when there are some changes from a previous period. So, entities subject to reporting should be limited to such entities that are added or deleted. This modification is expected to reduce reporting burden of banks and reviewing burden of supervisors.

4. Supervisors to which the results of the step-in risk self-assessment should be reported

We would like to confirm that a supervisor to which the result of the step-in risk self-assessment should be reported is a home authority of respective banking groups.

Paragraph 104 sets forth that supervisors should share information with those in other jurisdictions regarding the supervision of step-in risk for banking groups with branches or subsidiaries across multiple jurisdictions through, for example, supervisory colleges. Given this, it would be sufficient to require banks to report the result of the step-in risk self-assessment to their home authorities and home authorities to share information with those in other jurisdictions. This approach could eliminate unnecessary reporting burden arising from requiring banking groups to make a similar report to their host authorities.

5. Implementation date

Given that this regulatory framework intends to assess “residual risk” that cannot be captured by the regulations which have been developed so far, this framework shall basically be implemented only after a series of regulatory reforms currently being undertaken (including a framework to enhance the soundness of the shadow banking sector such as the asset management sector) are completed. If this framework would be implemented in parallel with the other regulatory reforms, the scope of “residual risk” may need to be reviewed every time new regulations are implemented.

The BCBS requires this framework to be entered into force no later than end-2019. The implementation of this framework, however, would require considerable period for preparation since step-in risk is a new risk concept and hence individual banks need to establish relevant risk management frameworks, and discussions between national regulatory authorities and banks would be essential for rule setting at respective jurisdiction. Therefore, a preparatory period of about two years from the finalization of the guideline may not be sufficient for each bank to complete its efforts to comply with the framework. We propose at least three years should be set aside from the finalization.